IN THE

Supreme Court of the United States

October Term, 1940

No. .....

CHAPMAN BROTHERS COMPANY, a corporation,

Appellant,

vs.

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,

Appellee.

BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions of the Courts Below.

The decision of the District Court was not reported, but appears in the Transcript of the Record, Vol. I, pages 99-109.

The opinion of the Circuit Court of Appeals is reported in 111 Fed. (2d) 86.

The opinion of the Circuit Court of Appeals, after stating the case, is as follows:

> "If the findings of the trial court are sustained by the evidence it is clear that the *proposed* plan of reorganization is lacking in good faith under the express definition thereof contained in the Chandler Act, Sec. 146, 11 U. S. C. A., Sec. 546, which provides that 'a petition shall be deemed not to have been

filed in good faith if * * * '(3) it is unreasonable to expect that a plan of reorganization can be effected'. Such a lack of good faith requires a dismissal of the petition.

"It is unnecessary to elaborate this question of 'good faith' in a petition for reorganization, as it has been so recently considered by this court, (Provident Mt. Life Ins. Co. v. University Ev. L. Church, 9 Cir., 90 F. 2d 992) and by the Supreme Court. Tennessee Pub. Co. v. American Nat. Bk., 299 U. S. 18, and Case v. L. A. Lbr. Prod. Co. Ltd., 308 U. S. 106. This case last cited *is directly applicable to the facts of this case,* for it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act, Sec. 77B, sub. f, 11 U. S. C. A., Sec. 207, sub. f." (Italics ours.)

Jurisdiction.

The jurisdiction of this court is invoked in Chapter IV, Section 24a, National Bankruptcy Act, U. S. Code, Title II, as amended generally by the Act of June 22, 1938. The decision of the Circuit Court of Appeals for the Ninth Circuit was filed on the 10th day of April, 1940.

28 U. S. C. A. 347, Judicial Code, Section 240a. The decree to be reviewed was entered April 10, 1940, and reported in 111 Fed. (2d) 86.

This court has jurisdiction to review the judgment of the Circuit Court of Appeals (28 U. S. C. A. 347), Judicial Code, Sec. 240a; 43 Statutes 936.

Statement of the Case.

The facts as stated in the petition: Chapman Brothers Company, a California corporation, for many years operating hotel properties, grocery store, drug store, restaurant, dwelling houses, apartments and other mercantile establishments, with no bonded indebtedness, no preferred stock, but common in the amount of $100,000.00, all issued and outstanding in the hands of three branches of the Chapman family, none outstanding in the public. This corporation executed certain deeds of trust securing the payment of the indebtedness evidenced by promissory notes of your appellant dated the 5th day of December, 1935, in favor of Security-First National Bank of Los Angeles, as beneficiary, whereby the appellant conveyed unto the Los Angeles Trust and Safe Deposit Company of Los Angeles, a corporation, as Trustee, those certain 18 parcels of real property located along Wilshire Boulevard and Sixth Street. The promissory note and deeds of trust were executed to secure the extension of credit by the Security-First National Bank of Los Angeles to the petitioner in the sum of $1,800,000.00, the same being dated December 5, 1935; also to secure note dated May 25, 1936, for $50,000.00, due December 5, 1940, interest payable monthly, principal payments in installments on the main note of $2500.00 on the first day of each month beginning February 1, 1937, to and including November 5, 1940, the balance on December 5, 1940.

Contemporaneously with the execution and delivery of the $1,800,000.00 note, Charles C. Chapman executed in favor of Security-First National Bank of Los Angeles a certain guaranty guaranteeing the payment of $250,000.00 on principal note, which guaranty was paid in September of 1937, in the amount of $294,000.00 curing all previous defaults in said appellant's notes.

By reason of certain defaults thereafter in the repayment of certain moneys, said Security-First National Bank of Los Angeles filed appropriate proceedings in the county courts for the foreclosure of said trust deeds; the properties were noticed for sale by the trustees named in the instruments of trust at public auction, the sale set for the 4th day of March, 1939. On March 1, 1939, your petitioner filed the voluntary petition hereinbefore mentioned, under 77B of the National Bankruptcy Act as amended June 22, 1938 (Chapter X, Chandler Act), alleging total assets in the amount of $3,095,802.65 [Tr. Vol. I, pp. 34-35], exclusive of good will, liabilities of $2,305,922.50, or a net worth of $789,880.15.

The answer of the Security-First National Bank filed in the above bankrupt proceedings alleged generally a lack of good faith in filing the petition, lack of equity in the properties, and alleged a total fair market value of the real estate only to be the sum of $1,262,736.00, and that it was unreasonable to expect that a plan of reorganization could be effected (the Security-First National Bank holds about 90% of all claims against the debtor), and prayed that the debtor's petition be dismissed.

In the petition there was only a suggestion of a plan by which the petitioner intended to seek permission from the court first to amend its charter by appropriate proceedings before the Secretary of State of the State of California, and then on appropriate application filed with the Corporation Commissioner of the State of California, that petitioner be allowed to issue bonds or preferred stock and sell the same to the public, if authorized to do so by the court, and that under a new plan of operation, and adapting the properties to new uses, petitioner could hold its equities in the form of common stock, no dividends to be declared thereupon until retirement of the bonds

and preferred stock consistent with the earnings of petitioner under new uses to which the properties were to be put, and in accordance with an appropriate budget reserve set up from such earnings so as to enable said bonds and preferred stock to be retired.

Trial was had before the court upon the issues raised by the answer and the trial court found petitioner hopelessly insolvent and that it was unreasonable for the debtor corporation to expect that any plan of reorganization could be effected, and, therefore, deemed the petition was not filed in good faith.

Upon appeal, the Circuit Court of Appeals for the Ninth Circuit confirmed the trial court.

SPECIFICATIONS OF ERROR.

1. That the Circuit Court of Appeals erred in holding that there was a lack of good faith required by the present statutes.

2. That the Circuit Court of Appeals erred in holding that the appellant was hopelessly insolvent.

3. That the Circuit Court of Appeals erred in holding that it is unreasonable to expect that a plan of reorganization can be effected.

4. That the Circuit Court of Appeals erred in holding that the petition should be deemed not to have been filed in good faith.

5. That the Circuit Court of Appeals erred in holding that the petition showed such a lack of good faith as required a dismissal of the petition.

6. That the United States District Court erred in denying the amendments of appellant to the findings of fact filed by the Security-First National Bank of Los Angeles in respect of the value of appellant's assets.

ARGUMENT.

Point One.

The decision of the Circuit Court of Appeals here has determined,—since the amendments of June, 1938 (Chapter X of the Chandler Act), National Bankruptcy Act,—particularly in respect of section 146 of said Chapter X relating to good faith in the matter of filing a petition, that such must be deemed to have been filed in *bad* faith if the said petition does not contain a workable plan of reorganization.

Section 146 of the National Bankruptcy Act provides as follows:

> "Sec. 146. Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—
>
> "(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or
>
> "(2) adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; or
>
> "(3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> "(4) a prior proceeding is pending in any court and it appears that the interests of creditors, and stockholders would be best subserved in such prior proceeding."

It is urged that Congress here meant that a petition in all cases should be *deemed to be in good faith* if it did not fall under the negations contained in subdivisions 1 to 4 of said Section 146, and that everything, therefore, that did not fall within those negations, should be deemed to be good faith.

The decision of the Circuit Court of Appeals cites *Provident Mt. Life Ins. Co. v. University Ev. L. Church*, 90 Fed. (2d) 992; *Manati Sugar Co.*, 75 Fed. (2d) 284; *Tennessee Pub. Co. v. American Natl. Bk.*, 299 U. S. 18, each of which cases reveals a factual situation respecting the difference between appraised values of assets and liabilities far worse than the instant case, *yet in each and every one of those cases the court permitted the debtor the right to submit plans of reorganization for the approval or rejection of the court.* Whether the appellant herein could have made workable the suggested plan in the petition, if given the permission, or could have presented another plan that might have been construed by the court to be feasible was not allowed.

Elon L. Brown, expert witness for the Security-First National Bank, testified [Tr. Vol. I, p. 150], in connection with his definition of fair market value, that a reasonable time under said definition in which to find a purchaser would be somewhere up to two years.

The case of *Manati Sugar Co. v. Mock*, 75 Fed. (2d) 284, on the matter of good faith, appellant thinks substantiates its position. By re-examination of this entire opinion the court will find that it was a *creditor's petition for relief and not a debtor's* and that the Circuit Court in this case affirmed the dismissal of the creditor's petition for reorganization as having been properly dismissed as insufficient; that the corporation's financial position was not shown, no reorganization plan was even tendered, no facts *were pleaded showing the possibility of reorganization.*

In the instant case the debtor's financial condition has been shown in its petition and in the evidence. The possibility of a reorganization plan with responsible prospects

interested has been tendered as shown by evidence of G. A. Chapman [Vol. I, p. 230], under the operating agreements tendered by the National Hotel Company, one Barney Goodman and others. This debtor corporation is a going business, and the Security-First National Bank *has not alleged facts nor established facts by the evidence showing reorganization is impossible*, so it is urged that in light of the provisions of Chapter X of the Chandler Act, this case is in support of debtor's petition and not in opposition to it. In this case, the court said:

> "We do not mean to say that the petitioner cannot be heard unless they have a reorganization plan fully worked out and ready for immediate consideration, but it is essentially sufficient to show that one may be forthcoming," citing the matter of *235 West 46th Street C. Inc.*, 74 Fed. (2d) 700.

As is said in *Union Nat. Bk. v. Lehmann Higginson Grocer Co.*, 82 Fed. (2d) 969:

> "The judge is not limited in his search of good faith or the want thereof. The court will take into consideration all pertinent facts."

In re Surf Bldg. Corp., 11 Fed. Supp. 295, the court said:

> *"I am not in sympathy with the view that good faith demands proof of feasibility of a plan tendered at the time the petition is filed."* (Italics ours.)

A possibility of reorganization should exist.

In re South Coast Co., 8 Fed. Supp. 43;

In re Francfair, 13 Fed. Supp. 513;

R. L. Witters Associates, Inc. v. Gypsum Co., Inc., 93 Fed. (2d) 746.

The primary purpose of 77B and certainly as amended by the Chandler Act is a strong element in urging for the approval of a petition. *If there is a real possibility of reorganization, the purposes will control the court's discretion.*

In re National Dept. Stores, 8 Fed. Supp. 19;

In re A. C. Hotel, 93 Fed. (2d) 841;

In re Dutch Woodcraft Shops, 14 Fed. Supp. 467.

It appears to appellant that the Circuit Court of Appeals has decided this case on the point of whether a *plan* has been submitted in good faith, and not whether the petition was filed in good faith. *The trial court did not permit appellant to reach the plan-submitting stage.* If the evidence shows the debtor has reasonable expectation of submitting a workable plan, appellant contends that under the true intent and purpose of Congress, and consistent with the spirit of the above decisions, the opportunity to submit plans should have been given by the trial court to the debtor.

The evidence of G. A. Chapman [Vol. I, p. 130, *et seq.*] clearly establishes the debtor is a going business; that during the entire year 1938 and up to and inclusive of March 1, 1939, it had earned and paid the salaries of 75 employees, paid for the upkeep of the properties and earned all of the taxes, and earned slightly in excess of one-half of the interest requirements of the total indebtedness. (Debtor's Exhibit 6, auditors' reports.)

Debtor alleged it had assets of over $3,000,000.00. Security-First National Bank, by its answer, alleged that debtor had no assets in excess of approximately $1,300,000.00.

In order for the court to entertain appellee's view, it is necessary that the court believe unqualifiedly *from the evidence* that this said Bank's *appraisals of December, 1934, were actually* less than the value placed on the identical properties *at that time* by the said Bank. For the court to find that there is no evidence in the record establishing the values placed on the properties by the appellee under its 1934 appraisement would require that the court completely reject appellee's 1934 appraisements and to conclude from the indefinite evidence of the Bank's expert witnesses, Raymond F. Ahern, George F. Struble and Elon L. Brown as to the values testified to at the date of trial, May, 1939, that the values of these properties had decreased from $3,095,000.00 plus as of December, 1934, to an amount of $1,262,000.00 plus as of the date of trial, May, 1939. It is the contention of the debtor that the evidence introduced at the trial shows that there is no difference in values as of December, 1934, and as of May, 1939. All of the above named experts who testified expressed the opinion as experts that there was at the date of trial certain areas in Los Angeles in which properties had advanced in price since 1934.

R. T. Adams, an officer of Security-First National Bank, testified that $1,374,500.00 was the bank's appraised value of 15 of the 18 parcels involved as of December, 1934 [Tr. Vol. I, pp. 192-193]. These did not include the parcels known as the Brown Derby corner or the hotel parcel [Tr. I, pp. 205-211].

R. T. Adams, appellee's witness [Vol. I, p. 193] admits that it loaned money of the Bank on a basis of 50 or 60

per cent of the appraised values of said Bank placed on properties. During the years 1934, 1935, 1936, this Bank loaned appellant debtor corporation $1,800,000.00, using the appellee's December, 1934, appraisals as a basis, the properties were evaluated as of said date at $3,095,000.00. In logical sequence and in substantiation of such appraisement, the appellee loaned 60% of $3,000,000.00, namely, $1,800,000.00, and as late as 1936 loaned $270,000.00 [Tr. Vol. I, pp. 192-194] for the construction of the bungalows.

Appellee cannot escape the effect of the testimony of its own witness [Tr. I, p. 194] where it offered the debtor corporation *$1,000,000.00 for only 6 of the 18 parcels involved under the main loan.* This obviously does not square up with the testimony of the Bank's expert witnesses as to values as of the date of trial, May, 1939.

Section 203 of the Chandler Act provides as follows:

> "Sec. 203. If the acceptance or failure to accept a plan by the holder of any claim or stock is not in good faith, in the light of or irrespective of the time of acquisition thereof, the judge may, after hearing upon notice, direct that such claim or stock be disqualified for the purpose of determining the requisite majority for the acceptance of a plan."

It is to be emphasized that the appellee, Security-First National Bank, holds approximately 90% of the secured indebtedness, *that is, including the trust deed to the Trust Department of said Bank.*

It is to be emphasized that certificates are outstanding against the loans of the Trust Department, the holders of

which certificates have not been disclosed to the court or to the debtor and this debtor given an opportunity to deal with said certificate holders [Tr. Vol. I, pp. 195-199].

As to who are the true creditors of a debtor, see *In re Loeb Apts.*, 89 Fed. (2d) 461.

Point Two.

Whether it is error for district judge to refuse to amend the findings as to the fair market value of the properties of the debtor where there is evidence furnished by the creditor's own record to support a finding of a much greater value than that found by the said district court.

The testimony of G. A. Chapman [Tr. Vol. I, pp. 20-60] discloses that G. A. Chapman, vice-president of debtor corporation, made appraisals of various properties of the debtor and used as a basis for said appraisals the appraisals made by the appellee Bank in December, 1934 [Debtor's Exhibit 13, pp. 170-178, Tr. Vol. I] wherein on such basis only 15 parcels of the 18 involved were appraised at $1,374,500.00, as of December, 1934.

Elon L. Brown, witness for appellee Bank, testified [Tr. Vol. II, p. 125] that the total value of all the assets of the debtor was $1,260,736. In a breakdown of this figure contained in subsequent testimony of appellee's witness, Mr. Brown [Tr. Vol. II, pp. 126-170] and in the breakdown of the testimony of appellee's witness Raymond F. Ahern [Tr. Vol. I, pp. 170-175] and appellee's witness R. T. Adams [Tr. Vol. II, pp. 176-199], as compared with the testimony of G. A. Chapman [Tr. Vol. I, pp. 20-60] based upon the appraisals made by the appellee bank in December, 1934, were able to draw the following comparison chart of appraisals.

	Bank Appraisal 1934 as base	Ahern	Security Bank's Witnesses May 1939 Valuations Adams	Brown	Struble
Hotel, land, equipment, garden, bungalows—but not including Wilshire frontage 130 ft. deep	$844,700.00	$540,000.00	$605,000.00 not including furnishings	$262,600.00	.....
Market	350,000.00	85,000.00	.....	93,600.00	.....
Brown Derby corner	271,250.00	127,000.00	.....	186,000.00	.....
632 South Alexandria, 75 x 155	.....	.....	.....	10,500.00	$15,000.00
Kenmore Parking, 115 x 150	28,750.00	.....	.....	8,050.00	11,500.00
Vacant, Normandie, 6th, Mariposa	196,750.00	.....	.....	41,700.00	57,500.00

From the testimony of Mr. R. T. Adams, witness for the Security Bank [Tr. Vol. II, pp. 176 to 199], we ascertain that the figure of $1,374,000.00 representing the Security Bank's appraisal as of December 7, 1934, did not include the bungalow construction costing independently approximately $270,000.00 in 1936; did not include the hotel, appraised by the Security Bank in 1934, as disclosed by the testimony of R. T. Adams, with equipment, at approximately $400,000.00, nor the Brown Derby corner, northeast corner of Wilshire and Alexandria, 155 feet Wilshire frontage, appraised by the Security Bank in December, 1934, at $271,250.00. *The above identical property* INCLUDING, *instead of excluding,* the hotel, bungalows and Brown Derby corner, were appraised in April of 1939 by Elon L. Brown, witness for the creditor Security Bank *at only $996,514.00* [Tr. Vol. II, p. 126 *et seq.*]. The testimony of R. T. Adams [Tr. Vol. II, pp. 208 to 212] showed that as of December 26, 1935, the Security Bank appraised the hotel parcel, which was parcel

16, 145 by 155 feet, at $72,500.00 for the land, and $327,-500.00 for the improvements, or a total of $400,00.00; that as of the same date, December 26, 1935, the Brown Derby corner, 155 by 145, northeast corner of Wilshire and Alexandria, was appraised at $242,500.00; the same witness [Tr. Vol. II, pp. 209 to 212], testified that combining the 1934 appraisal of Security Bank on 15 parcels, and the 1935 appraisals on 2 additional parcels, makes an increase of $632,500.00, or a total of $2,007,000.00; in other words, an added loan in cash by the bank since December 7 of 1934 of $632,500.00. Deducting the said $632,500.00 from the $996,514.00 representing the appraisal made in January of 1939 by Elon L. Brown upon the same properties, which the bank had appraised December 7, 1934, at $1,374,000.00, places a value upon the same of $361,514.00, which does not make sense. This distortion and insufficiency of the evidence to support the bank's contention that all of said properties of the appellant were worth less than $1,300,000.00, is further emphasized by the testimony of R. T. Adams, witness for the Security Bank [Tr. Vol. II, pp. 179 to 199] wherein there was offered to the debtor corporation for the hotel block, namely, for *only 6 parcels* out of 18 parcels, the same being parcels 6, 7, 13, 14, 16 and 18, the sum of $1,000,000.00 in October of 1938, upon which identical 6 parcels Mr. Brown, despite the above offer of $1,000,000.00, appraised in 1939 [Tr. Vol. II, p. 130] at $590,100.00. Under Mr. Brown's own definition of "fair market value," his appraisement testimony here becomes completely valueless.

Throughout the cross-examination of Mr. Raymond F. Ahern, expert witness for Security Bank [Tr. Vol. II, pp. 180 to 182], George F. Struble, expert wit-

ness for the Security Bank [Tr. Vol. II, pp. 215 to 224], cross-examination of Elon L. Brown, expert witness for the Security Bank [Tr. Vol. II, p. 141], it was impossible to get clear and convincing testimony from said expert witnesses as to what per cent increase or decrease, if any, in values of such properties there had been between the dates of December 7, 1934, when the bank appraised the 18 parcels at a figure in excess of $3,000,000.00, and appraised the identical parcels in 1939 at $996,514.00. It is clear from the above that it was erroneously assumed that the evidence fully sustains the finding of fact that the debtor corporation is *hopelessly insolvent.* It is clear from the evidence above referred to, that the appraisements made by the Security Bank's expert witnesses as of January, 1939, and from the fact that there is *no evidence* in the record that prices of such properties have materially decreased since December of 1934 and January, 1939, that the debtor *is not hopelessly insolvent but* has a substantial equity in these properties on which the Security Bank alone has a lien of trust deed.

Summary of Argument.

The Court of Appeals here has rendered a decision in conflict with the primary purposes of the statute (see hearings before Committee of House Judiciary on H. R. 6439, June, 1937; later H. R. 8046), and with principles announced by the courts.

In re South Coast Co., 8 Fed. Supp. 43;

In re National Dept. Stores, 8 Fed. Supp. 19;

In re Surf Bldg. Corp., 11 Fed. Supp. 295;

In re A. C. Hotel Co., 93 Fed. (2d) 841;

First Nat. Bank of Wellston v. Conway Road Estates Co., 94 Fed. (2d) 736;

In re Dutch Woodcraft Shop, Inc., 14 Fed. Supp. 467.

In considering the question of whether there existed an equity in the debtor, a parity of situations and reasoning appears in Section 580 (a), California Code of Civil Procedure:

> "Sec. 580a. Whenever a money judgment is sought for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, the plaintiff shall set forth in his complaint the entire amount of the indebtedness which was secured by said deed of trust or mortgage at the time of sale, the amount for which such real property or interest therein was sold and the fair market value thereof at the date of sale and the date of such sale. * * * The court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property or interest therein sold at the time of sale with interest thereon from the date of the sale; provided, however, that in no event shall the amount of said judgment, exclusive of interest after the date of sale, exceed the difference between the amount for which the property was sold and the entire amount of the indebtedness secured by said deed of trust or mortgage. * * *"

In enacting Section 580 (a) of the California Code of Civil Procedure, the Legislature apparently had in mind

the fact that creditors in lending money upon the security of a trust deed or mortgage are careful to lend less than the fair market value of the land, and, further, that in making such a loan, creditors are cautious to lend an amount less than the anticipated market value at any such time as it may be necessary for the creditors to resort to that security in satisfaction of the indebtedness, for the Legislature places the burden upon the creditors to show that the land taken was not worth the amount of the debt. This portion of the argument is addressed to Point Two, that is, the finding of the trial court that the evidence established beyond any possible doubt that no plan could be presented that would afford relief to the debtor.

In September, 1937, in excess of $294,000.00 was paid by the debtor's guarantor reducing the principal, with certain adjustments of interest, to $1,530,000.00 as of September, 1937. [Rep. Tr. Vol. I, p. 188.] The testimony is clear that all defaults in interest, taxes, or otherwise were, in every respect cured, that is, fully paid as of September, 1937, and that the proceedings started in the Superior Courts of Los Angeles County for the foreclosures of the trust deeds on all these properties had, therefore, occurred in the short period of time, to-wit, September, 1937, up to March 1, 1939, when the proceedings in the United States District Court were filed. The appellee bank offered the appellant $1,000,000.00 for the hotel property alone, that is, 6 parcels of the 18 involved. [See Vol. I, p. 194.]

It may take more to satisfy a judge that he should dismiss a voluntary petition for lack of good faith than an involuntary one. *In re National Dept. Store,* 8 Fed. Supp. 19.

In re Delaware Building Corp., 14 Fed. Supp. 96, at 101, jurisdiction is more extensive in voluntary proceedings than in involuntary cases.

In the case of *Central State Life Insurance Co. v. Koplar*, 80 Fed. (2d) 754, the court said, in connection with the matter of good faith respecting the filing of petitions and in construing the old 77B:

> "It is a special proceeding which seeks to bring about a reorganization if a satisfactory plan to that end can be devised *and to prevent the attainment of that object is to defeat the very end the accomplishment of which was the sole aim of the section and thereby to render its provisions futile.* The matter of granting permission to foreclose outside of the bankruptcy court and without regard to any plan of reorganization, present or future, is addressed not to the power of the court but to its discretion. * * * The evidence conclusively showed that there was then, when order was entered, no market whatever for the hotel. So, says the court, it is not difficult to see that if sold now no one except appellant could or would be a bidder at such sale and an unnecessary sacrifice of value would occur with the result that the deficit to be allowed in favor of appellant as a general creditor would be shockingly unjust to the estate and to other unsecured creditors, and also to the holders of bonds secured by the second mortgage. The income from its operation was increasing at a rate which, if continued, would more than take care of overhead, taxes and interest on the first mortgage for the current year. Without more we are of the opinion that the discretion vested by law in the court was not abused when he refused to permit foreclosure to appellant." (In this case the creditor was the petitioner.)

The extreme extent to which courts have gone in assisting toward working out a reorganization plan, is revealed in *Barclay Park Corp.*, 90 Fed. (2d) 595. Under the mortgage securing the bonds, there was a total liability of approximately $4,112,000.00. Of this amount, approximately $2,130,000.00 was in arrears. The bonds secured by the mortgage on the leasehold amounted to in excess of $1,000,000.00 in addition to interest thereon which had been unpaid since December 1, 1931. The interest alone amounted to upwards of 32½% of the principal of the bonds. The PLAN confirmed by the District Court was reversed by the Circuit Court.

Chief Justice Hughes, in 299 U. S. 18, said:

> "Nor do we need to inquire as to the precise limits of the concept of good faith as required by section 77-b. Whatever these limits may be, the *statute clearly contemplates the submission of a plan of reorganization* which admits of being confirmed, as fair, equitable and feasible." (Italics ours.)

Point Three.

Whether the right of the bankrupt in possession to show a reasonable probability of rehabilitation and given an opportunity to present a plan of reorganization is conditioned upon a plan being completed at the time the petition is filed.

Some courts have felt that a literal judicial obeisance should be given to congressional mandate to approve a properly drawn petition and have freely admitted submission of plans where a possibility of reorganization appears to exist.

In re Witters Associates, 93 Fed. (2d) 746.

In the case of *Tennessee Pub. Co. v. American Natl. Bk.*, 299 U. S. 18, appraisal of debtor's property showed *assets* worth $295,000.00. Outstanding bonds secured by mortgage were in default and amounted with interest to approximately $900,000.00. There were unsecured claims of about $300,000.00. The District Court approved the petition *and allowed submission of plans for reorganization.* Three successive plans of reorganization were submitted and opposed. Finally the District Court dismissed the petition and the affirmance of that decree was reviewed on certiorari. The factual situation in the instant case has no such gross distortions and yet the debtor corporation, stockholders and trustees have not been given the opportunity to submit plans for a determination of their feasibility.

See, also:

Hickey v. Ritz-Carlton Hotel Co., 96 Fed. (2d) 748.

The main question involved in this case was whether or not the petition was filed in good faith. The debtor had issued $5,500,000.00 of 6% bonds secured by first mortgage. Until July, 1931, the debtor operated the hotel, paid the interest on the bonds, and in addition paid $1,997,000.00 on principal. In October of 1934 the trustee owed trade obligations of $85,000.00, taxes of $190,000.00. In this case the property was admitted to be worth about $2,500,000.00. On the matter of good faith the court said:

> "The court's discretion is exercised as the exigencies of each case demand."

"Good faith" is not a mere concept demanding strict adherence without regard to the particular facts and circumstances of each case. Such questions may call for a different answer today from that at future time, even though the cases may be the same in the main and may perhaps involve assets and liabilities of a similar nature and substantially like amount. Such variables may be the personnel of the creditors and stockholders, the general economic conditions may have changed, or, while such general conditions may remain substantially the same, yet the conditions of the particular industry of the class in which the debtor belongs may have changed so materially that reorganization may seem not feasible. The court will take into consideration all pertinent facts.

In re Antone Bldg. Corp., 88 Fed. (2d) 329;

Union Nat. Bk. v. Lehmann Higginson Grocer Co., 82 Fed. (2d) 969;

Manati Sugar Co., 75 Fed. (2d) 284.

In *Witters Associates Inc. v. Gypsum Co. Inc.*, 93 Fed. (2d) 746, the court said:

> "We agree with appellant. The statute as to corporations eligible to file a petition is broad and comprehensive. Under it, any corporation which could become a bankrupt may file an original petition. Nowhere in the statute is there any definition of good faith. What is meant by the term must be drawn from the meaning of the words themselves as interpreted by the context in which they are used, the purpose back of the statute, the mischiefs it was enacted to prevent, *the results it was enacted to accomplish.* * * * It *should not, however, before the stage of plan submitting has arrived,* examine into the feasi-

bility of reorganization with the searching intensity required, when a plan or plans having been submitted by the petitioner, the good faith and feasibility of plans for reorganization come directly up.

"Under that rule, where the good faith of the filing is attacked before the plan submitting stage has been reached, unless the impossibility of conforming to and obtaining the benefits of the statute clearly appears, the petition should not be dismissed as not filed in good faith. It should be retained and questions of plan and reorganization worked out in the thorough and complete way the statute provides for later steps in the proceedings. What then is meant by the statutory requirement that the petition be filed in good faith is that it must appear that the petition, voluntary or involuntary, was filed not with the purpose of harassing the debtor or of hindering or delaying creditors. The district judge did not find in this case, under the evidence he could not have found, that it was beyond the bounds of reasonable possibility that within the time and under the processes the statute afforded, a plan might be presented under which the benefits of the statute could be properly extended to the debtor. *He could not properly have done so, for the debtor had submitted no plan,* and the decision of the question at the time and under the state of evidence would have been premature. As the record stood on appellees' motion to dismiss the petition, there was no ground for finding that it was not filed in statutory good faith and it was error to dismiss it." (Italics ours.)

On the question of whether a plan is fair and equitable, some lower courts have stated their views in *dicta* (*Downtown Investment Co. Association v. Best,* 81 Fed. (2d) 314, 18 Fed. Supp. 822, 14 Fed. Supp. 910), and decisions

in 93 Fed. (2d) 841, 86 Fed. 293. In other words, there exists even *in the matter of submission of a plan variables* that resist standardization but before the variables in connection with the submission of a plan are encountered, the plan submitting stage must have been reached in the proceedings.

This Circuit Court, 111 Fed. (2d) 86, in deciding this case, held that *Case v. L. A. Lbr. Products Co. Ltd.*, 308 U. S. 106, was *directly applicable* to the facts of this case.

> "For it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act, 77B, sub. f, 11 U. S. C. A., section 207, sub. f."

It is to be emphasized in the above *L. A. Lbr. Products* case that the debtor was a holding company owning all the stock of six subsidiaries, that the L. A. Shipbuilding and Dry Dock Corporation had fixed assets of $430,000.00 and current assets of $400,000.00. The debtor's liabilities consisted of principal and interest of $3,807,000.00 on first mortgage bonds secured by a trust indenture covering the fixed assets, and the stock of all the subsidiaries. In 1930 a *voluntary reorganization* was effected with the assent of 97% of the face amount of the bondholders. Mr. Justice Douglas said:

> "All those interested in the estate are entitled to the court's protection. Accordingly, the fact a vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one."

It appears the inescapable conclusion and presumption from this case and as stated by Chief Justice Hughes in

the *Provident Mutual Life Insurance* case, *supra,* that an actual plan must be submitted to the court before a petition is dismissed.

We therefore urge that the Circuit Court has a misapprehension of the facts when it states that the *Los Angeles Lumber* case is directly applicable to the facts of the instant case. Where there appears to be incorrect statements of fact in the appellate court's opinion, and such can cause grave injustice or misapplication of a proper rule of law, it becomes increasingly urgent, of course, for the protection of the appellant here, for the court to review the instant case with great care.

Of course, any plan actually submitted under all decisions following the original 77B must be fair and equitable, but of course a plan submitting stage must be reached before a plan can be said to be unfair or inequitable or unworkable. Conceivably, there are many instances in which the actual market value of all the assets of a debtor corporation at a particular time during a depression, and under forced sales conditions, could not be sold on the open market for sufficient to satisfy all the debts; on the other hand, there are many instances where if an opportunity is given to debtor to reorganize and he makes the superhuman effort to contact all friends and acquaintances for a transfusion of new blood into the sick corporate body and adapts the property to new and more lucrative uses, that it might be so revitalized as to warrant the belief and expectation that the plan will eventually pay off the creditors.

"I am not in sympathy with the view that good faith demands proof of feasibility of a plan tendered at the time the petition is filed."

In re Kelly Springfield Tire Co., 10 Fed. Supp. 417;

Manati Sugar Co. v. Mock, 75 Fed. (2d) 285;

In re Lehrenkraus Co., 10 Fed. Supp. 14.

As regards the necessity of a plan being complete at the time the petition is filed, the court said, in *Kelly Springfield Tire Co.,* 10 Fed. Supp. 417:

"It has been held that it is too narrow a construction of the provision relating to good faith to hold that a plan must be formulated when the petition is filed."

Under Section 216, subdivisions 1 and 2, Chapter X of the Chandler Act, permissive provision, a plan may be provided for altering or modifying the rights of stockholders, to be sure, but the plan may be *with all or any part of the property of the debtor.*

Section 216, subdivision 2, partial plan or plans in series have been approved.

In re Prudence Bond Corp., 79 Fed. (2d) 205;

Central States Life Ins. Co. v. Koplar Co., 80 Fed. (2d) 754.

It is urged, therefore, that the debtor's petition is not untenable because the petition contains no *completed plan of reorganization,* and that to insist upon such a rule or theory is violative and inconsistent with the provisions of Chapter X of the Chandler Act.

Conclusion.

It will be observed throughout the decisions above quoted that the important point is that in *extreme* cases the debtor corporation was allowed a chance to reorganize, which appears to be the philosophy and purpose that Congress had in mind when passing the Chandler Act.

From the foregoing evidence, argument of principles and the statutes and authorities cited, it is apparent that in order to satisfy the true purpose of Congress as shown by the liberal language of Section 146 of the Chandler Act, that the debtor should have a free opportunity to submit plans of reorganization.

Whether we like it or not, or whether we admit it or not, the fact remains that we are today in an era of new financing, as well as in a new political and social era, and the cold actuality is that a new and elastic liberality has grown up, and properly so, during these depression years, toward distressed debtors. The Chandler Act was designed precisely to assist the type of debtor that this petitioner is. The answer of the Security Bank on file, by failing to deny, admits that this debtor corporation has paid to this Security Bank in excess of $1,000,000.00 in interest alone for the rental of money. It now finds itself embarrassed due, in the main, to the distressed condition of the world. This counsel readily admits that the properties themselves have not been put to the very best uses from an earning standpoint, and that this court, in the event it grants the relief prayed for, should urge and insist that the trustees use every means available from the experience of this court and from the purposes set forth in the Chandler Act, to see that the properties are put to the best uses from a financial standpoint.

The properties of the debtor corporation are in the heart of a great growing city which will continue to grow. The evidence discloses that encouraging improvements have lately been placed in this area; that petitioner has such substantial assets adaptable to other and divers uses with enormous potentialities and that the future definitely presages increased values for these properties, and that with the properties put under a new plan of operation and adapted to the most lucrative types of enterprises that the future should assure the creditors that they will eventually be paid off their debts.

Congress and the courts have learned much in the past ten years, particularly that debtors like this petitioner get into trouble in the main through no fault of their own, but due to the conditions of the world as a whole, and decreased business generally. But America and California have survived these periods and marched forward to higher ground and they will continue to do so.

We repeat that the properties have not been put to the best use from a money-making standpoint. The debtor corporation has catered only to the more select clientele, cultured people, but since times have not improved as rapidly as have been expected and the properties are now in the hands of the court, we pray that the court may assist the debtor in so diversifying the uses of the property from a financial point of view solely by adapting some of them to different uses, such as the sale of liquor, de luxe shops and other uses disclosed by the evidence as will so enable the debtor to increase its income and properly pay off the loans against the properties.

It is our point, if the court please, that in this new world of rapidly changing values and untried theories, it is more

logical to say that some inflation may follow which is likely to treble the present values of these properties than to say they will be worth less than the Security Bank has placed upon them.

We submit respectfully that were it permissible under the rules of this court—to be wholly consistent and logical —and to follow through with the position taken by the Security Bank, that it is not too much to say that were the federal government itself, or even the state government, before this court on a similar petition, with its balance sheets and financial statements spread before the court for analysis, that on a present net income showing this court would be forced by following the Security Bank's arguments to deny both the federal government or the state government the right or opportunity to put its house in better shape, or reorganize.

It is respectfully submitted that in refusing debtor an opportunity to submit plans for reorganization and in the other instances mentioned, the Circuit Court erred, and that such errors should be here corrected.

It is respectfully submitted that the petition should be granted, that a writ of certiorari should be issued as prayed for because the decision of this court is necessary to correct wide conflicts and confusions and vagueness in the administration of bankrupt cases.

Respectfully submitted,

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